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THE RELATION OF THE NATIONAL RESERVE ASSOCIATION TO THE TREASURY

One of the merits of the Reserve Association plan is that it contemplates the complete withdrawal of the federal government from the banking business. Ever since the government was organized, it has undertaken to carry on banking operations in some form or other; first, as part owner of a great commercial bank; then, when that experiment seemed unsuccessful, and for the last seventy years, as the custodian of its own vast revenues and checking accounts, and finally, during the last half-century, as the exclusive manager of that branch of banking which has to do with the issue of circulating notes. No other important commercial country, at least none of the countries of western Europe, has attempted for several generations to engage in government banking in any of these forms, either as owner or part owner of a commercial bank, or as maintaining a separate depositary for its own funds, or as handling the issue and redemption of bank notes.

Our government has long since ceased to participate in the ownership of commercial banks, and among the multitudes of proposals for banking legislation, sane and insane, with which the country has been flooded during recent years, I have yet to see the first suggestion that it should attempt a repetition of the banking experiments of its early decades. We need not, therefore, devote time to considering the idea of a government-owned bank. There is no danger that Congress will ever again consider seriously

the revival of a United States bank. Our government still continues, however, to act as its own banker, and still continues to monopolize the note-issuing function of our entire banking system. With regard to the maintenance of both of these conditions there are serious grounds for objection.

First, in regard to the effort of the government to serve as its own banker. No other government in the world is so ill adapted as ours to act as its own banker. Under governments with responsible cabinets, such as exist practically everywhere else, the machinery is provided for a balanced budget and an approximate equivalence of revenue and expenditure. Such governments are not confronted with alternating and unpredictable surpluses and deficits, and even if their funds were intrusted, as in this country, to an independent treasury, there would result no such haphazard and disturbing withdrawals of money from the banks and from circulation, or equally upsetting reinjections of money into the currency as have occurred here from time to time. In our government system, however, we have neither the machinery to insure a balance between income and outgo, nor even a serious purpose to attain such a balance. Under our peculiar methods one pair of congressional committees prepare the bills for raising money, while another independent and much larger group of committees prepare the bills for spending it, and no individual or committee is seriously charged with the duty of adjusting the balance between them. Moreover, our revenue measures have ordinarily been framed with other considerations in mind than raising revenue, while not infrequently the appropriation bills have reflected little or no regard for the country's income. In certain past years we have been confronted with a deficit amounting to over a hundred million of dollars; in other years with a surplus of like proportions; and the effect of these vagaries in our budget, if the independent treasury had been consistently maintained, would have been a corresponding addition to, or deduction from, the country's currency without the slightest regard for the demands of business.

In the face of such a situation, with revenues and expenditures see-sawing in alternate surpluses and deficits, successive secretaries

of the Treasury during the last decade and a half have seen fit largely to qualify the independent treasury as a depositary of the government's working balance and have adopted instead, as the only possible alternative, the deposit of a considerable proportion of the general funds with particular banks. In pursuing this policy, they are still hampered at every turn by a hodge-podge of outworn laws; but what makes the system really objectionable is the fact that it inherently involves injustice and inequality in the treatment of different banks. To name one instance of the fettering effect of outgrown laws, under present legislation the Treasury is in the anomalous position of holding large balances with banks in the larger cities where there are subtreasuries without being able to draw upon these accounts to make expenditures. In fact, though during the last ten years we have held on deposit with such banks anywhere between $10,000,000 and $150,000,000, we have been obliged under existing laws to transfer these funds from the banks to the subtreasuries before checking against them. The banks, in other words, have enjoyed the full use of the money during the greater period and in most cases are still doing so without paying interest, while the Treasury has been obliged to bear the expense of handling it. Another anomaly under the present law is that customs revenue cannot be legally deposited with the banks in any subtreasury city.

But even if these anomalous provisions of the law were straightened out, the system would remain objectionable because of the inevitable discrimination and inequality which results from the selection of particular banks as depositories. We have at present 423 regular depositories and 939 so-called "temporary depositories." (The latter, having been the recipients of substantial sums in the days when the Treasury enjoyed a surplus, are today reduced to a nominal holding of $1,000 each.) All of these institutions enjoy the distinctive privilege of advertising on their doors, in the press, and on their circulars and stationery the fact that they have been designated "United States depositories," thus conveying to the uninstructed the false impression that they have been selected because of the peculiar assurances of safety, or of credit, which they offer. Yet, as all bankers know, the 1,362 institutions

selected as United States depositories are no more worthy of confidence of distinctive preference by the government than the 5,969 other institutions under federal charter, nor are they so regarded by the government. Moreover, among the 423 active depositories, the Treasury's authorized balance varies from $25,000 in some institutions to $1,200,000 in others, and these differences, though of considerable financial importance to the banks concerned, as is evidenced by the importunate demand for such balances on the part of bankers and their congressional representatives, cannot in the very nature of the case be adjusted between the banks upon any basis of equity. The government balances must be primarily distributed according to the localities in which revenues are collected or disbursed. Try as we will in the Treasury to temper our business requirements with considerations of equal treatment of the banks, inequalities in abundance are bound to persist. Even in the same cities sometimes there are national banks with government balances of nearly a million, side by side with other national banks of equal size without any government funds at all. The very system involves unwarranted discrimination between banks which are designated depositories and those which are not, and among the depositories it involves inequitable distinctions between those which are regular and those which are temporary, and between those with large and those with small balances. It means selection, means unavoidable favoritism, means appeals from congressmen and senators, means complaints and criticism. The whole system is wrong.

It is highly important therefore that the monetary plan now before the public proposes a mechanism by which, on the one hand, the government's haphazard surpluses and deficits can be prevented from effecting any serious alterations in the currency supply, and by which, on the other, the manifold injustices and discriminations as between banks, which are inherent in the present system of handling government funds, can for the future be completely eliminated. If the plan is adopted, the government's general funds and all future revenues will be deposited with the National Reserve Association and the annual disbursements, amounting to a billion or more dollars, will be made through that

institution and its branches. The government accumulations will thus be kept at the continuous disposal of all the banks and through them in the uninterrupted service of the public, and never again need the government balance serve as a disturbing factor in business, or as a source of inequitable discrimination between the banks.

Second, in regard to the activities of the government in the management of note issue and redemption.

Ever since the Civil War, or for nearly half a century, the issue of circulating notes, which in every other leading country has been regarded as an essentially banking function, exclusively appropriate to the banks, has in the United States been treated as an exclusive function of the government. In Great Britain, so far as I am aware, the government has never issued any notes except the interest-bearing exchequer bills, which have never served as means of payment and which can scarcely be classed as circulating notes. In France the government has issued no notes since the fateful period of the assignats and the mandats in the eighteenth century. In Germany the imperial government has issued no notes since its establishment except the very unimportant amount of treasury notes emitted at the foundation of the empire in redemption of certain obligations of the preceding régime.

The American government similarly, for three-quarters of a century after its lamentable experience with Colonial and Revolutionary currency, abstained from further incursions into the credit field and, except for momentary relapses during the War of 1812 and the war with Mexico, issued no fiduciary money. It was the dire extremities of the Union government during the Civil War which led to a reversal of this policy, and it was the prolonged duration of the war and its consequences which gave the reversal a momentum that has continued to the present day. Both the greenbacks and the so-called national bank circulation were credit devices to provide the government with the means to prosecute the war. Both were, and continue today, the equal obligations of the government. With the greenbacks the government borrowed directly from the people; with the bond-secured, so-called bank-note currency, the government borrowed indirectly, the banks

lending to the government in the first instance, then being allowed to borrow an equivalent amount from the people under government guaranty.

The two systems of currency are alike objectionable, because the conditions of their increase or decrease have only to do with the balance between the government's revenue and expenditure and have no relation whatever with the needs and qualifications of the country's business for circulating media. In their ultimate analyses, I find little difference in this respect between the system of fiat government money, represented by the greenbacks, and the so-called bank currency that the government issues to any bank which offers government bonds as collateral. It means, in either case, that the currency increases when the government has to borrow and decreases when the government repays its debts. In either case, it opens a tempting and precarious way by which a weak government can enter upon undertakings for which it is not financially prepared at the risk of inflating the currency and undermining business credit.

It is doubtless upon some such accounts as these that the great European countries have long since abandoned the government issue of notes and have, without exception, avoided the American system of indirectly issuing government notes by allowing their issue in substitution for deposited government bonds.

The circulating notes, like the circulating ledger balances or deposit accounts, ought to be part and parcel of the credit machinery of a country. They are not essentially or even naturally related to government finance. The amount of circulating notes which is needed and which can be safely issued is not a multiple or coefficient of the government's need for revenue, but depends upon the general character and trend of business, upon the quantity of standard or lawful money available as a basis for credit, and upon the extent to which credit in other forms is already in existence. Of all of these factors in their various relations at any given moment, neither Congress nor any executive department of the government is likely to offer the most expert judgment. They are factors requiring for their just appraisal the most experienced and the most disinterested financial opinion based upon the widest relations

with banks and business throughout the country; and it is to such expert determination, rather than to the government or to the individual bankers, that the extension or diminution of the note credit of the country ought to be intrusted.

Now it is to just such authority that the control of note issue is relegated in the suggested plan. The government is to be taken out of the business of note issue at least in so far as the greater part of the fiduciary issues—the bank notes—are concerned; and these issues are to be permanently divorced from their present illegitimate relations with the government bonds.

I shall not attempt to treat here of the details of the plan of this divorce. It is already well known how the National Reserve Association is to take over the note issue and the bonds from the national banks, how the government is to refund the 2 per cent bonds into three's, and how the Reserve Association is to pay a sort of alimony for fifty years after the divorce has been effected. The net result of all these arrangements is this: That the country will get forever rid of the unscientific, unresponsive, and dangerous government bond-secured currency; that the note circulation will once more become an integral part of the credit machinery under carefully framed legislative safeguards and under the most expert and most disinterested management which the banking community can provide; that the banks will be able to dispose of their artificially valued bonds at par; that the Reserve Association will hold these bonds on such a refunded investment basis that it will be able to dispose of them from time to time without probable loss; and, finally, that the government will, without additional expense, be able to refund $700,000,000 of its debt for fifty years at a net interest charge of only 1½ per cent per annum.

So two of the important activities of the federal Treasury will be transferred under the suggested plan from the government to the Reserve Association: first, the handling of the government funds and their disbursements; and, second, the issue and redemption of bank notes. This will effect great changes in the Treasury administration and will make possible great economies to the government. The adoption of the plan will make it possible to

dispense with the nine subtreasuries and with much of the work relating to them in the Treasury in Washington. As for the trust funds of the government, the gold and silver held against certificates, and the 150 millions in gold held against the greenbacks, such of these funds as are now held in the subtreasuries can be transferred to the mints and the Treasury in Washington, or they can be deposited in the vaults of the Reserve Association and its branches, to be held there intact and inviolate as trusteed moneys. Of course, the vast majority of our trusteed gold (940 out of 1,140 millions) and silver (346 out of 489 millions) is already held in the mints and assay offices and in the Treasury in Washington. We hold, however, a considerable amount of gold in the subtreasuries at Chicago (84 millions), San Francisco (32 millions), New York (33 millions), and St. Louis (27 millions), and a considerable number of silver dollars in the subtreasury in New York (81 millions). This could be transferred to the neighboring mints or to the Treasury in Washington, but if, as is quite within the range of possibility, the Reserve Association were to rent from the government the subtreasury buildings in New York and San Francisco and the subtreasury offices in other cities, the custody of the funds now in these buildings and offices could be transferred under proper safeguards without disturbing their locations to the Reserve Association, acting as trustee.

The elimination of the subtreasuries from the expenses of the government will involve economies of perhaps a million dollars. The appropriations for salaries in the subtreasuries for the year 1912 amount to $535,390, all of which might be saved in the future. To this should be added most of the appropriation for the division of public moneys, which during the current year amounts to $30,660 for salaries, and most of which could be dispensed with, also $170,000 for contingent expenses, practically all of which could be dispensed with, as well as expenditures of between $30,000 and $40,000 annually in the cashroom of the Treasurer's office. If we take account of the rental value of the subtreasury buildings in New York and San Francisco, and of the space in federal buildings now occupied by subtreasury offices in Baltimore, Boston, Chicago, Cincinnati, New Orleans, Philadelphia, and St. Louis,

all or part of which might be rented to the association, or devoted to other purposes, we can estimate an aggregate annual saving to the government from the elimination of the independent treasury of approximately a million dollars.

The further functions which the Reserve Association may assume later in serving as the fiscal agent of the government need not be considered now, but it is quite probable that it will eventually prove expedient also to transfer to this institution much of the machinery connected with the handling of the public debt and the interest payments thereon which now belongs to the Division of Loans and Currency, to the Register's Office, and to the Loans Division of the Treasurer's Office, and that important further savings may be possible to the government.

In the transfer to the association of the business of bank-note issue and redemption, the government will effect further important savings. It is of course impossible to say how soon under the suggested plan the issue of notes by individual national banks would come to an end. The fact that the Reserve Association offers to take over only the 2 per cent bonds at par during the first year of its existence, and the fact that the notes of the Reserve Association would soon come to have a kind of standard quality the world over, preferable even to the government-secured national bank notes, would doubtless cause the majority of the national banks to transfer their bonds to the Reserve Association and to deposit money for the retirement of their own notes within the first year. On the other hand, it is altogether probable that among the seven thousand national banks there would be many, especially of the smaller banks, which would cling with pride, even at the risk of financial sacrifice, to the individual circulation; and undoubtedly even if money were deposited for the retirement of all bank notes, it would require several years to effect their complete retirement. In the meantime, some machinery for redemption will probably have to be continued in the Treasury. The British government in 1844 took steps to restrict the issue of bank notes in England to the Bank of England, and yet there still exist some seventeen small note-issuing banks aside from that institution.

The German government in 1875 took steps toward the transfer of all note issue to the Reichsbank, yet there still remain four note-issuing banks in Germany. It is not unlikely that in this country note issue by a certain number of banks would continue for many years, unless directly or indirectly interfered with by legislation. Possibly an insistence that the banks should bear *all* of the expenses of preparing the notes would help in facilitating the transition. But probably sooner or later it will be necessary to increase the tax on individual bank circulation in order to effect its extinction. Until such legislation is obtained, the Treasury will have to maintain some limited machinery for issue and redemption. Assuming, however, that the vast majority of the individual bank notes will be retired almost immediately, a very large saving will be possible to the Treasury. During the present year the Treasury has been involved in annual expenditures in connection with the bank notes as follows:

In the Division of Loans and Currency:			
For distinctive paper..................	$ 57,000		
For handling this paper...............	2,600		
		$ 59,600	
In the Bureau of Engraving and Printing:			
For engraving plates..................	$ 5,471		
Printing of notes.....................	541,416		
		$546,887	
In the Office of the Comptroller of the Currency:			
Issue Division........................	$ 34,880		
		$ 34,880	
In the Treasurer's Office:			
Loans Division..................about	$ 12,000		
		$ 12,000	
			$653,367

The transfer of the business of issuing and redeeming national bank notes to the Reserve Association would therefore result in a saving to the government of about $650,000 annually, and the aggregate annual saving from the elimination of the remnants of the independent treasury and of the national bank circulation would be in the neighborhood of $1,700,000.

It would be premature at this time to attempt to add to this figure an estimate as to the amount which the government will

receive from the Reserve Association in taxes and surplus profits, but this undoubtedly will be reckoned annually in the millions.

And so the Treasury will save upward of 1,700 thousand dollars per year and will receive profits of several millions more, in ridding itself of two branches of activity for the conduct of which it has always been ill equipped and which it ought never to have assumed. One of these, the bank-note circulation, was undertaken only as a measure of war, but has lagged on superfluous for a half-century thereafter; the other, the independent treasury, though it has been on the statute books a longer time, really collapsed years ago, and for at least a decade has maintained only a limping existence. We shall see them both go with benefit to the country and profit to the government.

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